

CRESCENT PORTER HALE FOUNDATION

IBLA 87-221

Decided April 27, 1989

Appeal from a decision of the District Manager, Roswell District, New Mexico, Bureau of Land Management, reducing overriding royalty rate for potassium leases. NM LC 067319-A, NM LC 067319-B, NM LC 067319-C.

Affirmed.

1. Potassium Leases and Permits: Readjustment--Res Judicata

Regardless of any deficiency in the readjustment of a potassium lease, the matter will be entitled to repose under the doctrine of administrative finality in the absence of any timely objection by the lessee or the owner of an overriding royalty interest after notice of the readjustment and in the absence of any compelling legal or equitable reasons for further review.

2. Potassium Leases and Permits: Royalties--Regulations: Applicability

BLM may properly reduce the overriding royalty rate for a potassium lease pursuant to regulatory authority previously incorporated into the lease at the time of readjustment, notwithstanding the fact that the rate was originally established prior to the original promulgation of that regulatory authority.

APPEARANCES: Jon J. Indall, Esq., Santa Fe, New Mexico, for appellant; James L. Dow, Esq., Carlsbad, New Mexico, for the Amax Potash Corporation; Margaret C. Miller, Esq., Office of the Field Solicitor, U.S. Department of the Interior, Santa Fe, New Mexico, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE KELLY

The Crescent Porter Hale Foundation (Crescent), current holder of an overriding royalty interest in potassium leases NM LC 067319-A, NM LC 067319-B, and NM LC 067319-C, has appealed from a decision of the District Manager, Roswell District, New Mexico, Bureau of Land Management (BLM), dated October 29, 1986, reducing the overriding royalty rate from 3-1/2 to

2 percent for the period October 1, 1986, through December 31, 1987, with respect to those leases.

Applications for potassium prospecting permits were filed by Mabel E. and Elwyn C. Hale. While those applications were pending before BLM, the Hales entered into an agreement with the Southwest Potash Corporation (Southwest) on May 27, 1949. This agreement provided that the Hales would assign to Southwest any permits subsequently issued by BLM and that Southwest would thereafter initiate a drilling program and, upon determining that the land contained a commercial deposit of potassium or associated ores, obtain a potassium lease for such land. The agreement further provided that after a lease was issued, Southwest would construct, maintain, and operate a mine and treatment facilities for the production and processing of potassium and associated ores and pay the Hales a royalty of 3-1/2 percent of the gross value of the output of potassium compounds and related products.

Potassium prospecting permits were issued to the Hales on June 7, 1949, and assigned to Southwest with the approval of the Secretary of the Interior. Effective September 11, 1950, BLM issued the three potassium leases involved herein pursuant to section 2 of the Act of February 7, 1927, 30 U.S.C. | 282 (1982). These leases encompass 7,677.68 acres of land situated in T. 19 S., R. 30 E., New Mexico Principal Meridian, Eddy County, New Mexico, and were issued

for a period of 20 years and so long thereafter as the lessee complies with the terms and conditions hereof and upon the further condition that at the end of each 20-year period, such reasonable readjustment of lease terms and conditions may be made therein as may be prescribed by the lessor unless otherwise provided by law at the expiration of such periods.

By decision dated January 18, 1971, after the expiration of the initial 20-year term of the leases, BLM notified Southwest of the proposed readjustment of the leases, setting forth various new terms and conditions, and requiring execution of enclosed lease forms and stipulations within 30 days from receipt of the decision. In particular, BLM stated that the leases would be readjusted to include the overriding royalty limitation set forth in 43 CFR 3503.3-2(c)(1) (1971), and section 2(n) of lease form 3140-2, October 1966, 1/ and that holders of overriding royalty interests must be notified of this limitation and acknowledge notice in writing to the lessee.

1/ Section 2(n) of the leases provides that the lessee agrees

"[n]ot to create, by assignment or otherwise, an overriding royalty interest in excess of 1 percent of the gross value of the output at the point of shipment to market unless the owner of that interest files his agreement in writing that such interest is subject to reduction or suspension to a total of not less than 1 percent of such gross value, whenever, in the interest of conservation, it appears necessary to do so in order to (1) prevent premature abandonment, or (2) make possible the economic mining of marginal or low-grade deposits on the leased lands or any part thereof."

Mabel E. Hale assigned her interest in the May 27, 1949, agreement to Elwyn C. Hale (Hale) effective January 1, 1970. Southwest notified Hale of the overriding royalty limitation by letter dated February 16, 1971. Hale acknowledged receipt of the February 1971 letter by letter dated March 1, 1971. On February 17 and 26, 1971, respectively, Southwest and BLM executed the readjusted leases, which were effective September 11, 1970.

On July 7, 1986, the Amax Chemical Corporation (Amax), successor-in-interest to Southwest as lessee under the leases, informed the District Manager that it was in the process of seeking a reduction in the overriding royalty rate from 3-1/2 to 2 percent from Crescent, successor-in-interest to Hale as holder of the overriding royalty interest. Amax stated that a reduction of the royalty rate was necessary because of a drastic decline in the price of potash in the last few years which had prompted it to close its mining operations. Amax concluded that with a reduction in the overriding royalty rate to 2 percent and a suspension or reduction in the payment of Federal royalties, it could reopen its mine. 2/

BLM's Southwest Region Evaluation Team (SRET) subsequently assessed the desirability of ordering the reduction of the overriding royalty rate pursuant to section 39 of the Mineral Leasing Act, as amended, 30 U.S.C. § 209 (1982), based in part on financial data submitted by Amax in connection with its April 16, 1986, request for a reduction in the Federal royalty rate with respect to the subject leases and three other Federal potassium leases in the Carlsbad area. In a July 17, 1986, report, SRET stated that, in order for the greatest ultimate recovery to occur, mining operations must be minimally successful, i.e., the operations must result in a normal profit. 3/ The report then assessed whether mining of the remaining reserves from April

fn. 1 (continued)

This language was taken from 43 CFR 3503.3-2(c)(2) (1971). This section replaced 43 CFR 194.27a(b) (1954) which was promulgated on Aug. 20, 1953, (18 FR 4952).

2/ On Mar. 23, 1982, BLM modified the leases, pursuant to a Feb. 16, 1982, request by Amax, thereby reducing the Federal royalty rate from 5 percent to a sliding scale rate between 2 and 5 percent. This action was taken "[i]n the interest of conservation, and in order to encourage the greatest ultimate recovery of the remaining low grade reserves." In addition, by decisions dated, respectively, May 16, 1986, and Aug. 18, 1987, BLM reduced the Federal royalty rate to 2 percent for the period June 1, 1986, through Dec. 31, 1987, and Jan. 1, 1988, through Dec. 31, 1989.

3/ The report indicated that a normal profit was especially important in Amax's case where, although the company then had a positive cash flow, it had experienced historic losses which a "marginal cash flow will not offset" (July 1986 Report at 1-2). In connection with its April 1986 request for a reduction in the Federal royalty rate, Amax provided data indicating that from October 1984 through February 1986 it had sustained losses of almost \$3.9 million with respect to production from all of its State and Federal potassium leases in the Carlsbad area. The July 1986 Report concluded that "[i]f the parent company is not satisfied with the future cash flow, it is highly likely the mine will shut down." Id.

1986 through March 1987 would be normally profitable given anticipated costs and revenues. SRET specifically calculated the anticipated profit rate, i.e., after tax net income as a percentage of gross revenue, for that period, given Federal and overriding royalty rates, respectively, of either 2 and 1.75 percent or 5 and 3-1/2 percent and compared this rate with the profit rate for other companies with potassium ore mining operations in the area of Amax's operations for the period 1983-85. As SRET explained in a subsequent amendment of the July 1986 report, in order to constitute a successful operation, a mining operation must be able to generate after tax net income equal to or greater than the threshold or normal profit rate. With respect to Amax's operations, SRET concluded that the profit rate in the case of the higher combined royalty rate (8-1/2 percent) would be 3.9 percent versus 5.66 percent in the case of the lower combined royalty rate (3.75 percent), and that the normal profit rate had ranged from 4.5 to 6.1 percent, which translated to a median rate of 5.7 percent. SRET described 3.9 percent as a sub-par profit rate, but noted that 5.66 percent was almost equal to the median rate. ^{4/}

Based on this report, the Deputy State Director, Mineral Resources, New Mexico State Office, BLM, concluded in a July 18, 1986, memorandum to the District Manager that "[a]lthough AMAX shows a positive cash flow for the projected period, the [July 1986 Report] suggests that it is highly likely that if royalties (including overriding royalties) are not reduced, the 'greatest ultimate recovery' of the resource may not be obtained." Accordingly, he stated that Crescent's overriding royalty rate could justifiably be reduced to 1.75 percent, but recommended a reduction to 2 percent in order to conform to Amax's stated intentions in its negotiations with Crescent and the corresponding reduction in the Federal royalty rate.

By letter dated August 18, 1986, the District Manager notified Crescent that Amax had requested BLM to reduce the overriding royalty rate for these leases from 3-1/2 to 2 percent and that information submitted by Amax supported a reduction. The District Manager stated, however, that it was affording Crescent the opportunity to submit any information it had that might affect the decision.

On September 25, 1986, Crescent expressed its opposition to the proposed reduction, questioning BLM's authority to order a reduction when the royalty interest was created before the promulgation of the regulations upon which BLM's action was based. Crescent urged BLM to make any reduction prospective, not less than 2 percent, and effective only until December 1, 1987, so as to conform to the terms of the reduction in the Federal royalty rate.

In his October 1986 decision, the District Manager reduced Crescent's overriding royalty rate from 3-1/2 to 2 percent for the period October 1,

^{4/} The record indicates that SRET subsequently revised its July 1986 Report in order to assess the affect on the profitability of Amax's operations of reducing only the Federal royalty rate to 2 percent. In these circumstances, SRET concluded that the profit rate would be 4.51 percent, which was considered below normal. July 1986 Report at 1-5.

1986, through December 31, 1987, based on the conclusion drawn from available financial data that a reduction was "necessary * * * in order to prevent premature abandonment and to make possible the economic mining of marginal deposits," in accordance with 43 CFR 3503.2-3 (1986). Crescent has appealed from this decision.

Effective November 1, 1986, BLM approved the assignment of all of Amax's interest in the leases to the Amax Potash Corporation (Amax Potash).

In its statement of reasons for appeal (SOR), Crescent raises two legal challenges to the reduction. First, Crescent contends that BLM lacked authority to reduce the overriding royalty rate pursuant to section 2(n) of the readjusted potassium leases because the readjustments were themselves invalid because BLM had failed to notify Southwest of its intention to readjust the leases prior to the expiration of their initial 20-year term. Crescent cites Rosebud Coal Sales Co. v. Andrus, 667 F.2d 949 (10th Cir. 1982), and Noranda Exploration, Inc., 69 IBLA 317 (1982), in support of this argument (SOR at 8). Both BLM and Amax Potash contend that BLM provided the requisite notice to Southwest prior to the expiration of the initial 20-year term of the leases.

Rosebud holds that BLM is precluded from readjusting a Federal coal lease where it failed to notify the lessee of the proposed readjustment prior to the expiration of a 20-year lease term, even though readjustment was required by the applicable statute, Departmental regulation, and the terms of the lease to take place at the end of the 20-year term. As the court said in Rosebud Coal Sales Co. v. Andrus, *supra* at 953, "the Department's attempt * * * by a belated notice to readjust the coal lease in issue was outside of the statutory authority of the Department and contrary to the terms of the lease." The principle enunciated in Rosebud was subsequently applied by the Board in Noranda, in which we concluded that BLM was likewise precluded from readjusting Federal potassium leases when it failed to notify the lessee of the proposed readjustment prior to the expiration of the 20-year term of the leases.

[1] Based upon the evidence presently before the Board, we must conclude that even assuming BLM failed to notify Southwest of its intention to readjust the leases prior to the expiration of their initial 20-year term, the matter is entitled to repose under the doctrine of administrative finality because no timely objection was made to the readjustment of the leases on this basis. Elsie v. Farington, 9 IBLA 191, 194 (1973), *aff'd* Farington v. Morton, No. S-2768 (E.D. Cal. Dec. 5, 1973). It is clear that Southwest did not object to the readjustment and, in fact, executed the readjusted leases. Accordingly, we must conclude that Southwest waived any objection it might have had to the readjustment based on the lack of prior notice of BLM's intention to readjust the leases. AMCA Coal Leasing, Inc., 86 IBLA 21 (1985), *aff'd*, AMCA Coal Leasing, Inc. v. Hodel, No. 85-C-730W (D. Utah June 20, 1986). Assuming, *arguendo*, that Crescent's predecessor-in-interest had the right to challenge the readjustment, we must conclude that it also waived any such right by virtue of its failure to timely object to the readjustment. Ida Mae Rose, 73 IBLA 97, 99-100 (1983). Finally, we can discern no compelling equitable or legal basis for reopening the question of the

propriety of the readjustment almost 16 years later. See Turner Brothers, Inc. v. OSMRE, 102 IBLA 111, 121 (1988); Carmel J. McIntyre (On Judicial Remand), 67 IBLA 317, 328 (1982), appeal dismissed, McIntyre v. United States, 568 F. Supp. 1 (D. Alaska 1983), aff'd, 789 F.2d 1408 (9th Cir. 1986).

Crescent next objects to what it characterizes as the retroactive application of 43 CFR 3503.3-2(c) (1971) to overriding royalty interests created prior to the original promulgation of that regulation in 1953. BLM and Amax Potash contend that the reduction was not a retroactive application of the regulation because the regulatory authority for the reduction was incorporated into the leases at the time of their readjustment in 1971, prior to the District Manager's 1986 decision. BLM asserts that "[t]he appellant's 'guaranty' of a 3-1/2 percent overriding royalty interest applied to the 'first 20-year contract,' but was subject to the readjusted terms of the lease when a 'new contract' was created, in this case, effective September 11, 1970" (BLM's Response at 8).

[2] We agree with BLM that there has been no retroactive application of 43 CFR 3503.3-2(c) (1971). At the outset, however, it is important to note that the District Manager's reduction was not taken pursuant to 43 CFR 3503.3-2(c)(2) (1971), which was essentially incorporated into section 2(n) of the readjusted leases, 5/ but rather pursuant to 43 CFR 3503.3-2(c)(1) (1971), which was codified at 43 CFR 3503.2-3(a) (1986) at the time of the District Manager's October 1986 decision. Section 3503.3-2(c)(1) (1971), which was originally promulgated as 43 CFR 194.27a(a) on August 20, 1953 (18 FR 4952), provided in relevant part as follows:

An overriding royalty interest may be created by assignment or otherwise: Provided, however, That if the total of the overriding royalty interest at any time exceeds one percent of the gross value of the output at the point of shipment to market, it shall be subject to reduction or suspension by the Secretary to a total of not less than one percent of such gross value, whenever, in the interest of conservation, it appears necessary to do so in order (1) to prevent premature abandonment, or (2) to make possible the economic mining of marginal or low grade deposits.

This regulation was not expressly repeated in the readjusted leases. Nevertheless, it was incorporated by language in each of the preambles of the leases providing that they were issued "pursuant and subject * * * to all reasonable regulations of the Secretary of the Interior now or hereafter in force, when not inconsistent with any express and specific provisions herein." Thus, when the leases were readjusted, the language of 43 CFR

5/ That regulation, as embodied in section 2(n) of the readjusted leases, simply required the lessee to obtain the written consent of the owner of a specified overriding royalty interest thereafter created by the lessee that such interest is subject to reduction or suspension. See Emmet F. Spencer, A-26620 (Aug. 13, 1953). This language clearly does not apply to overriding royalty interests already in existence.

3503.3-2(c)(1) (1971) was incorporated into them. The District Manager's subsequent reduction was, accordingly, effected pursuant to the outstanding terms of the readjusted leases.

Moreover, we conclude that Crescent and Amax Potash, as successors-in-interest to Hale and Southwest, are equally bound by the terms of the readjusted leases where, as Crescent points out and BLM agrees, the overriding royalty interest is clearly derived from the lessee's interest, which was itself created by the United States. Furthermore, as provided in the original prospecting permits and leases, as well as the regulations in effect at the time of their issuance (43 CFR 194.27 (1949)), the creation of overriding royalty interests was subject to the approval of the Department. Crescent concedes that its "rights are governed by its agreement with the lessee, subject only to the approval of the Secretary of the Interior" (SOR at 13). Thus, the interest of the owner of the overriding royalty interest can be considered no more immune from the effect of the subsequent readjustment of the underlying leases than that of the lessee. Any other interpretation would unjustifiably restrict the exercise of BLM's authority, which is intended to protect the Federal interest in full development and recovery of this public resource. Emmet F. Spencer, supra at 2.

In addition, we note that the May 27, 1949, agreement creating the overriding royalty interest involved herein specifically provided, at page 3, that Southwest agreed "to maintain in good standing each permit assigned to or lease acquired by it for said lands, and to comply with all of the rules and regulations of any department of Government having jurisdiction over such permits [and] leases." The agreement, which was binding on all successors, clearly recognized the authority of the United States to regulate, pursuant to applicable regulations, any activity under any permit or lease subsequently issued, including, as noted supra, the establishment and continuation of any overriding royalty interest. Moreover, at the time the agreement was executed, those regulations provided for readjustment of potassium leases. See 43 CFR 194.12 (1949). Indeed, the agreement itself provided, at page 5, that Southwest agreed "to comply with all provisions of said lease when granted to it or any amendments or modifications thereof." Thus, the parties also recognized the authority of the United States to alter the applicable lease terms. Accordingly, we do not accept that Crescent or its predecessor-in-interest had any reasonable expectation that the overriding royalty terms would remain static.

Finally, we conclude that 43 CFR 3503.3-2(c)(1) (1971) applied in the case of overriding royalty interests already in existence. The regulation was not explicitly prospective only. Rather, it generally provided that if an overriding royalty interest created by the lessee at any time exceeded 1 percent of the gross value of the output of potassium compounds and related products at the point of shipment to market, it "shall be subject to reduction or suspension by the Secretary." 6/ 43 CFR 3503.3-2(c)(1) (1971).

6/ We note that the version of the regulation in effect at the time of the District Manager's Oct. 1986 decision and currently in effect, 43 CFR 3503.2-3(a) (1986), is even more inclusive to the extent it provides that "[a]ny overriding royalty interest created by assignment or otherwise shall

Moreover, to hold that the regulation only applied to overriding royalty interests created after its original promulgation would defeat the obvious intent of the regulation which was to provide a mechanism to prevent the premature abandonment or discontinuation of mining with respect to any potassium lease. In addition, such an interpretation would prejudice not only the lessee, but also the United States and any other party holding a royalty interest in such leases. See Emmet F. Spencer, supra at 2.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

John H. Kelly
Administrative Judge

I concur:

Kathryn A. Lynn
Administrative Judge
Alternate Member

fn. 6 (continued)

be subject to the requirement, that * * * it shall be subject to reduction or suspension by the authorized officer." (Emphasis added.)